



What You Need to Know About the Minister's Housing Allowance

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Today's Presenters



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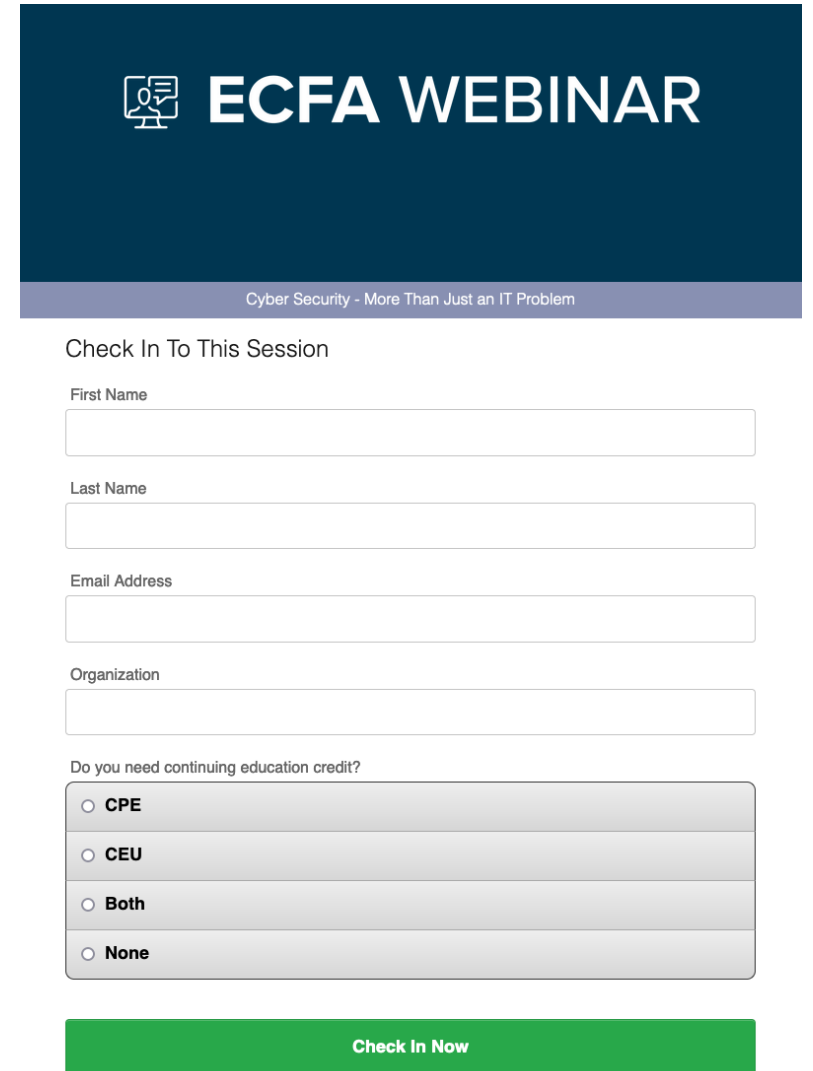
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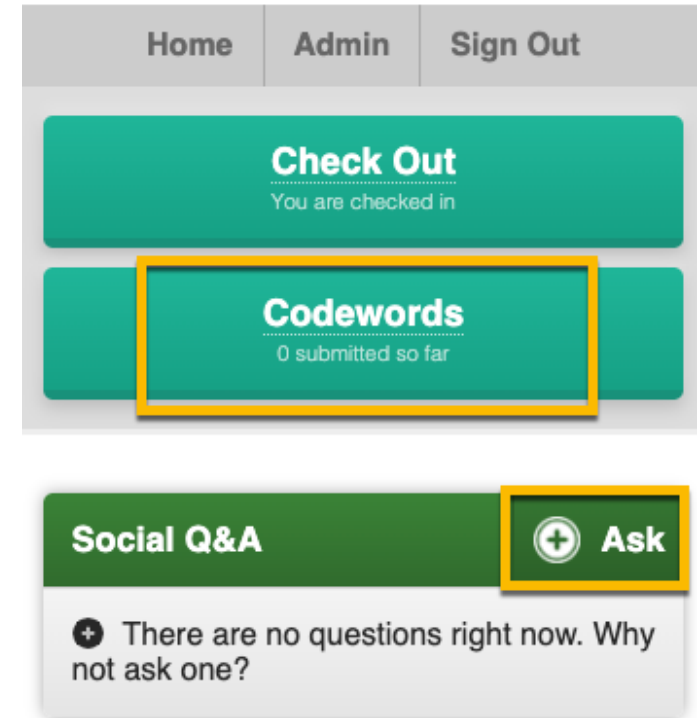
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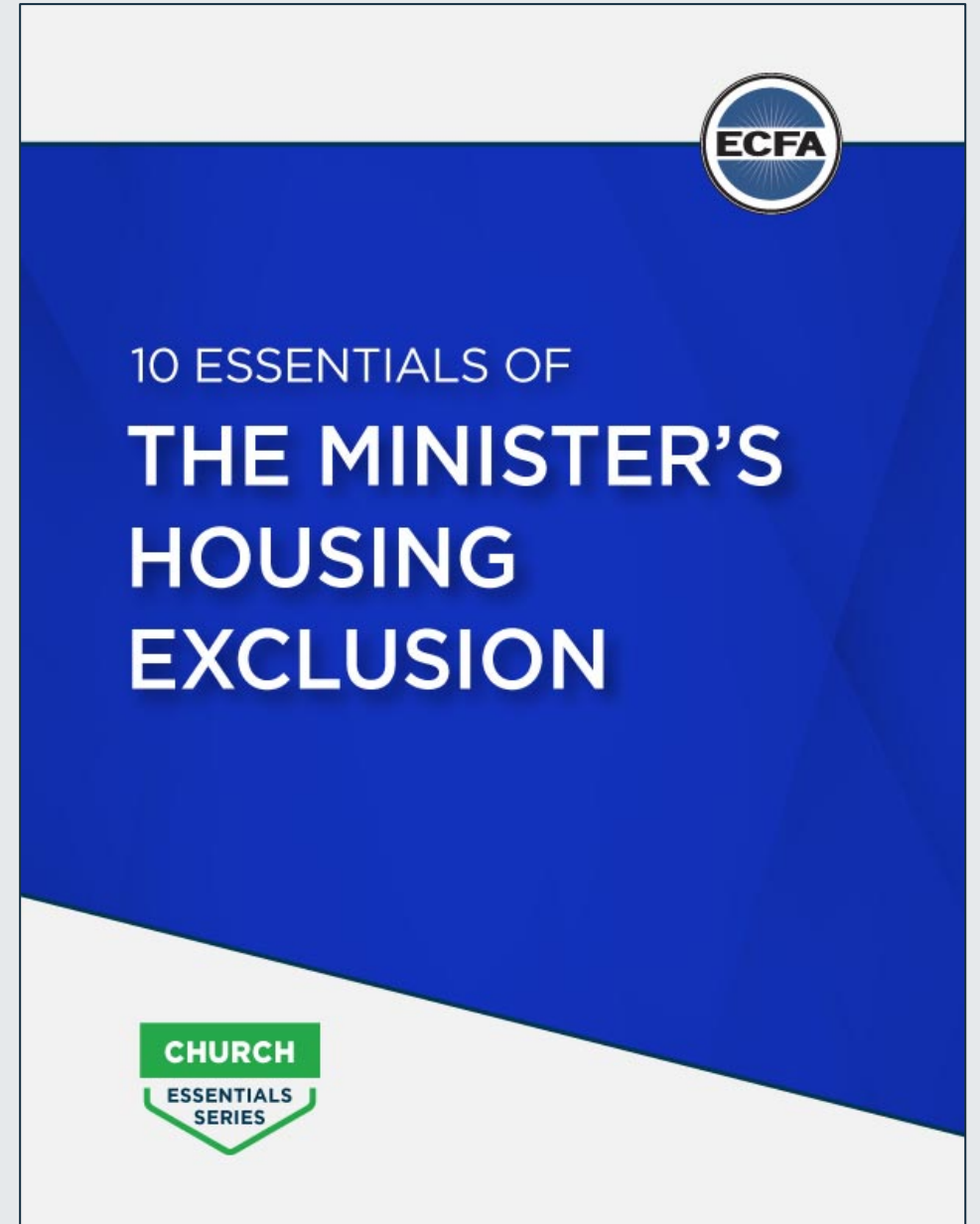
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Minister Taxation is Different

- Housing allowance saves taxes
- Withholding and estimated tax decisions
- Social Security is paid differently
- Bi-vocational possibility
- It's complicated!
- **Opportunities to make mistakes!**



Internal Revenue Code Section 107

In the case of a minister of the gospel, gross income does not include:

1. the rental value of a home furnished to him as part of his compensation; or
2. the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities.



Minister: WHO and WHAT

- The person must fit the definition of a minister (WHO)

AND

- Only payments for services performed in the exercise of ministry receive this tax treatment (WHAT)
 - Bi-vocational ministers, non-church, secular settings

Who is a “minister” for the purpose of taxation?

- *Knight v. Comm’r*, 92 T.C. 199 (1989)
 - **Must** be “ordained, commissioned, or licensed”
 - **Balancing test** for four other factors:
 - Administers sacraments
 - Conducts religious worship
 - Management responsibility in local church or religious denomination
 - Considered to be a religious leader by his or her church or denomination
 - **The presence or absence of any one of the four factors is not determinative**

What tasks are considered performed in the exercise of ministry?

1. Control, conduct, or maintenance of a church or integral agency of a church;
or
2. Sacerdotal functions or conduct of religious worship



1. Control, conduct, and maintenance of a church or integral agency

- Church & Integral Agency
- Executive or professional employee may be minister for taxation, even if not doing traditional minister tasks
 - Church: Weekly, quarterly, annual meeting; affiliation of meetings
 - Integral Agency: organization controlled by, or closely associated with, a church (e.g., denominational HQ, pension board, district superintendent)

2. Sacerdotal Functions and Conduct of Religious Worship

- Traditional minister tasks include:
 - Preaching and leading worship services
 - Spiritual counseling
 - Evangelism
 - Administration of sacraments (Eucharist or communion)
 - Religious observances (baptisms, marriages, funerals)
- Looking at the faith tradition of that church or organization (Treas. Reg. 1.1402(c)-5(b)(2))
- NOTE: These do NOT need to be done in a church



Another Path: Letter of Assignment

- A second path is through a letter of assignment from a church
- If a minister assigned by a religious body constituting his or her church works for an organization that is not a religious organization, work will be deemed services in the exercise of ministry (Treas. Reg. 1.1402 (c)-5(b)(2)(v))
- Assignment should occur before starting the job and should be directly related to accomplishing the church's purposes



Summing Up the WHAT

- Two “minister work” definitions:
 - **Working for church or integral agency:** performing traditional minister tasks, or work as a professional or executive
 - **Working anywhere else:** only sacerdotal functions or conduct of religious worship, **unless** working under letter of assignment



Minister's Housing Allowance



Internal Revenue Code Section 107

- In the case of a minister of the gospel, gross income does not include:
 1. the **rental value of a home furnished to him** as part of his compensation; or
 2. the **rental allowance paid to him** as part of his compensation, to the extent used by him **to rent or provide a home** and to the extent such allowance **does not exceed the fair rental value of the home**, including furnishings and appurtenances such as a garage, plus the cost of utilities

What about parsonages?

- **Rental value of parsonage**
 - Must be valued (fair rental value)
 - Subject to SECA
 - This amount is automatically excluded (no need for designation)
 - If there are other expenses (utilities, HOA fees, furnishings, maintenance, etc.), they can be excluded from gross income if there is a designation and subject to the applicable limit (see next slides)
- **Parsonage allowance**
 - Must be designated in advance, used to pay for parsonage-related expenses, and subject to the applicable limit (see next slides)



Housing Allowance

- The church board must designate housing allowance before it is paid (i.e., before beginning of the fiscal year, unless the minister start date is later in the year)
- If not done by beginning of year/employment, can still do it for expenses **going forward**
- Amount to be excluded from income is the **least** of:
 - Amount designated
 - Amount actually spent
 - Fair rental value

Ways It Can Go Wrong

- Someone uses an old roster of employees for the church board to vote on
- New minister starts but there is no designation and nothing in the offer of employment letter about a housing allowance
- Staff member wants the housing allowance to be retroactively changed

Housing Allowance

- Example
 - Church-designated housing allowance: \$21,000
 - House payment: \$1,200/month Utility bills: \$300/month
 - New sofa: \$500 Maintenance: \$1,000
 $(\$1,200 \times 12) + (\$300 \times 12) + \$500 + \$1,000 = \$19,500$
 - Real estate agent: house would rent for about \$1,700/month
 $(\$1,700 \times 12) + (\$300 \times 12) = \$24,000$

Amount designated	\$21,000
Amount spent	\$19,500
Fair rental value	\$24,000
Eligible Exclusion	\$19,500

Housing Allowance in Retirement

- Some or all of payments to retired ministers may be designated as housing allowance
- Payments made into 403(b) or other retirement plans by the church or denomination are in recognition of services provided by the minister
 - Thus, distributions out of the retirement plan are for past ministerial services, and therefore are eligible for the housing allowance

Housing Allowance in Retirement

- Whatever entity (church, denomination, plan trustee, etc.) is making the retirement payments must designate in advance the amount of payments that qualify as housing allowance
 - As a practical matter, some payors will designate 100% of the amount as housing allowance. The retired minister then determines and reports the actual amount of housing expenses each year on their Form 1040



Housing Allowance in Retirement

- Documentation challenges when funds are held by outside, non-church entity:
 - 403(b) plan must identify that it is established by a church, for church employees, as a church plan
 - Housing allowance distributions must be designated before distribution payments are made
 - Investment company making distributions may report the entire payment of Form 1099-R. Such companies should be encouraged to check the box that states “Taxable amount not determined”



Housing Allowance in Retirement

- To ensure 403(b) or other retirement plan distributions are properly reported on Form 1040, it is essential to use a tax professional thoroughly trained in and familiar with minister tax issues.

Some Questions

- Does the board have to approve all housing allowances?
- What about large down payments on a house? Extensive renovations?
- Can you designate a minister's entire salary as housing allowance?
- **Must** a minister be paid a housing allowance?



W-2 Issues



Minister Tax Reporting by Organization

- If Employee: Form W-2 and employee benefits
 - Same criteria as for other church workers in distinguishing “employee” from “independent contractor” for tax reporting and benefits purposes
 - No requirement to withhold federal income tax (and in most cases, state income tax)
 - **“Dual Tax Status”**
 - Employee for W-2 but deemed self-employed (like independent contractor) for Social Security tax. No withholding of FICA/Medicare tax from payroll.

Minister Tax Reporting by Organization

- Estimated Tax or Voluntary Withholding
 - Minister employees not subject to income tax withholding and FICA/Medicare should not be paid by church
 - Default expectation is that a minister will pay quarterly estimated taxes
 - Payments are due on April 15, June 15, September 15, and January 15 of the following year
 - However, minister can voluntarily authorize church to withhold
 - Withheld amounts that would have been FICA/Medicare are just additional federal income tax withholding



SECA – Self-Employment Tax

- SECA tax paid by ministers instead of the FICA/Medicare taxes paid by regular employees
 - Applies to regular compensation, the amount of the housing allowance, and to any other fees the minister has (e.g., weddings and funerals)
 - SECA tax reported on Schedule SE, filed with minister's own Form 1040; current rate is 15.30%
 - Some churches try to increase compensation to make up for the additional 7.65% tax paid by minister (for employees, the employee and employer each pay 7.65%, but ministers pay the full 15.3%)
 - Voluntary Withholding Option



SECA – Self-Employment Tax

- A minister can exempt out of SECA
 - Must be conscientiously opposed to receiving the benefits of public insurance (such as Social Security/Medicare), with respect to services performed as a minister, because of personal religious beliefs
 - Must file Form 4361 prior to the due date of the return for the second year in which he or she has \$400 or more of ministerial income
 - This is an irrevocable decision!



Other Thoughts

- Minister taxation is complicated!
- Be sure your tax preparer is knowledgeable and experienced with minister taxation issues.

Breaking News: The Clergy Act

- The Clergy Act, authored by Reps. Kevin McCarthy (R-Calif.) and Mike Thompson (D-Calif.), would allow a temporary window for ministers to revoke their exemption and re-enter the Social Security system beginning in 2026.
- The bill includes a requirement for the IRS to create and submit to Congress a plan for how it will notify clergy members of their eligibility for this opportunity.
- The House Ways & Means Committee unanimously advanced this bipartisan legislation in a 41-0 vote earlier this month.
- ECFA is a key supporter and will continue to advocate for this bill – a very helpful solution for ministers who mistakenly elected out of Social Security coverage early in their ministry.



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